BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JACK B. AND PETRONELA GAYER)

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Jack B. and Petronela Gayer to proposed assessments of additional personal income tax in the amounts of $5,735.27, $3,417.56 and $254.08 for the years 1951, 1952 and 1953, respectively.

Appellant Jack B. Gayer (hereinafter called appellant) owned a coin machine business consisting of about six multiple-odd bingo pinball machines and two music machines during 1951, 1952 and part of 1953. The business was managed by Irvin B. Gayer, appellant's father, who also managed his own coin machine business and that of his wife, M. D. Gayer. Appellant's equipment was placed in several locations such as bars and restaurants. The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally. Certain individuals collected from and repaired the machines in return for a third of the amounts collected from the locations.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were

taken for commissions, depreciation and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

There is some question whether the collectors were acting for themselves or as agents representing appellant in dealing with the location owners. Two location owners testified at the hearing in this matter. One stated that the machines were owned by appellant's father and the other stated that the collector who dealt with him worked for appellant's father. On his returns, appellant deducted as "commissions" the amounts retained by the collectors. Bearing in mind that appellant's father managed the business for appellant, we believe that appellant was the principal **and the collectors his agents in** dealing **with the location owners.**

The evidence further indicates that the operating arrangements between appellant and each location owner were the same as considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, P-H State & Local Tax Serv. Cal. Par. 58145. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

In Appeal of- Advance Automatic Sales Co.,' Cal. St. Bd. of Equal., Oct. 9, 1962, CCH Cal. Tax Rep., Par. 201-984, P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

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Respondent's auditor testified that during interviews in 1954 three location owners and a collector told him that cash was paid to winning players of appellant's bingo pinball machines for unplayed free games. The same collector testified at the hearing that he had no actual knowledge of payouts but that the location owners were reimbursed for whatever expenses they claimed and the expenses could have included cash payouts. One location owner testified that cash payouts were made and another testified that cash payments to players occurred only on occasions of machine malfunction. However, the latter location owner admitted that expenses might have been as high as 80 percent on one or more occasions and that the expenses on the machine would sometimes exceed the income for three or four successive weeks. Based on the evidence before us, we believe that it was the general practice to pay cash to players of the bingo pinball machines for unplayed free games. Accordingly, this phase of appellant's business was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying section 17359.

The entire coin machine business was integrated. For example, the collectors collected from and repaired both pinball machines and music machines. Consequently, we believe that there was a substantial connection between the illegal activity of operating bingo pinball machines and the legal operation of the music machines. Accordingly, respondent was correct in disallowing all expenses of the coin machine business.

There were no records of amounts paid to winning players of the bingo pinball machines and respondent estimated these unrecorded amounts as equal to 55 percent of the total amounts deposited in those machines. Respondent's auditor testified that the 55 percent payout figure was based on estimates given by three location owners and a collector. However, the auditor admitted that the collector interviewed had told him that his estimate of a 50 percent payout applied to only about half the locations. In addition, while an 80 percent payout estimate by one location owner was used by respondent in deriving its 55 percent figure, the same location owner testified at the hearing in this matter that expenses might have been as high as 80 percent on one or more occasions but this would not represent an average over the period. Considering all the evidence, we conclude that the payout figure should be reduced to 40 percent.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

XT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Jack B. and Petronela Gayer to proposed assessments of additional personal income tax in the amounts of $5,735.27, $3,417.56 and $254.08 for the years 1951, 1952 and 1953, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 7th day of January , 1964, by the State Board of Equalization.

Paul R. Leake , Chairman

John W. Lynch , Member

Geo. R. Reilly , Member

Richard Nevins , Member

, Member

ATTEST: H. F. Freeman , Secretary